

EMPLOYEES' RETIREMENT SYSTEM OF THE COUNTY OF MILWAUKEE

MINUTES OF THE JUNE 15, 2011 PENSION BOARD MEETING

1. Call to Order

Chairman Mickey Maier called the meeting to order at 8:30 a.m. in the Green Room of the Marcus Center, 127 East State Street, Milwaukee, Wisconsin 53202.

2. Roll Call

Members Present

Linda Bedford (Vice Chair)
Mickey Maier (Chairman)
Dean Muller
Dr. Sarah Peck
David Sikorski

Member Excused

Keith Garland

Others Present

Mark Grady, Acting Deputy Corporation Counsel
Gerald Schroeder, ERS Manager
Marian Ninneman, Operations Manager, ERS
Dale Yerkes, ERS Fiscal Officer
Bess Frank, Retiree
Ken Loeffel, Retiree
Yvonne Mahoney, Retiree
Ray Caprio, Marquette Associates, Inc.
Brian Wrubel, Marquette Associates, Inc.
Mark Sullivan, BNY Mellon
Michael Millette, BNY Mellon
Steven Huff, Reinhart Boerner Van Deuren s.c.
Steve Schultze, Reporter, *Milwaukee Journal Sentinel*

3. Chairman's Report

The Chairman thanked Chairman Holloway for reappointing him to the Pension Board and stated that he enjoys his service on the Board. The Chairman also noted that County Executive Abele is working on appointments to fill the remaining terms that expired or are close to expiring.

The Chairman then welcomed Dean Muller, the newest member of the Board. He noted that Mr. Muller is a financial advisor with Morgan Stanley who had served for many years on the Pension Study Committee. Accordingly, Mr. Muller brings both financial knowledge and County pension experience. Mr. Muller stated that he is happy to be serving on the Board.

The Chairman thanked the Board members and encouraged them to continue to make every effort to attend the meetings in order for the Board to continue conducting business with the required quorum. Until the elections occur, the Board is operating with only six members, so attendance is critical.

4. Minutes — May 18, 2011 Pension Board Meeting

The Pension Board reviewed the minutes of the May 18, 2011 Pension Board meeting.

The Pension Board unanimously approved the minutes of the May 18, 2011 Pension Board meeting. Motion by Ms. Bedford, seconded by Mr. Sikorski.

5. Reports of ERS Manager and Fiscal Officer

(a) Retirements Granted, May 2011

Ms. Ninneman presented the Retirements Granted Report for May 2011. One hundred and fifteen retirements were approved in May, with a total monthly payment amount of \$215,395. Of those 115 retirements, 105 were normal retirements and 10 were deferred vested retirements. Seventy-nine retirees elected backDROPs in amounts totaling \$14,247,214. Of these 79 backDROPs, 36 were under \$100,000, 38 were between \$100,000 and \$499,000, and five were over \$500,000. Additionally, of the 79 backDROPs, 42 chose the maximum benefit option and 20 selected Option 3.

Ms. Ninneman stated that May was one of the heaviest processing months for ERS since 2004, but that deferred retirements have slowed to approximately 10 to 15 per month and that the number of

retirement appointments has dropped. There are 41 appointments scheduled for June, 11 appointments scheduled for July, and 10 appointments scheduled for August. However, ERS anticipates an increase in appointments as a result of the Budget Repair Bill being passed.

Mr. Schroeder stated that in July, ERS will present to the Board a long-term projection of retirements based on the actuarial report. The projection includes a fact-based view of retirements over the next five years and ERS' recommendations of the resources needed to handle that influx. Currently, ERS is experiencing temporary emergency conditions because of the large volume of retirements. If these conditions continue long-term, they must be properly handled.

The Chairman stated that Marquette will need to be kept informed of these retirement conditions in order to coordinate asset allocation.

In response to a question from Ms. Bedford, Mr. Yerkes stated that there is enough cash flow, approximately two months' worth, to supplement the increasing number of backDROPs each month. Ms. Ninneman stated that ERS is in a better position to properly coordinate the timing of funding requests. Mr. Schroeder also responded that Marquette and ERS need to work together to anticipate increases over the next three months. The only real difference between a low retirement month and a high retirement month is volume. Employees are entitled to their benefits and while the backDROP amount may seem large, it is proportionate to the volume of retirement.

In response to a question from the Chairman, Mr. Schroeder stated that the long-term projection to be presented to the Board in July will factor in that the backDROPs will at some point become nonexistent.

(b) ERS Monthly Activities Report, May 2011

Ms. Ninneman presented the Monthly Activities Report for May 2011. ERS had 7,766 retirees at the end of May 2011, with a monthly payout of \$26,837,985.

Mr. Schroeder then presented an update on the election for the retiree seat and employee seat. The nomination process ended on June 6. There are three candidates for the retiree seat: Guy Stuller, a former Board member and certified financial planner; Elizabeth Frank, a former Zoo curator; and D.A. Leonard, a former County Budget Analyst. The primary election for the retiree candidates will

be held July 8 through July 11, with a final election on July 22 through July 25. For the employee seat, there are two candidates: Monique Taylor, an ERS Clerical Specialist; and Rex Queen, the Deputy County Treasurer. Because there are only two candidates for the employee seat, the primary election on July 8 through the July 11 will also be the final election.

Mr. Schroeder stated that ERS is currently trying to increase voting participation by using e-mail blasts and the newsletter communicator to promote the significance of holding a position on the Board. The goal is to reach a 30% retiree voting rate, which has been as high as 38% in previous years, and a 20% employee voting rate, which is double that of the last election. If ERS is successful, approximately 2,300 votes will come in during the retiree election and 900 votes will be cast in the employee election.

Mr. Schroeder then provided an update on the co-development process. This team is beginning to transfer the process of making enhancements to the V3 system from Vitech to ERS. The last six weeks has been spent in training with Vitech, setting up the equipment that can connect to the Vitech system in New York, and performing all necessary preparatory work. ERS expects no negative impact to the V3 system.

Mr. Schroeder then stated that ERS has started to perform low-level application development, such as letters and forms, which is Phase 3 of the co-development process and which is expected to be complete by the end of July. Phase 2 involves more intermediate-level development, and ERS expects that to occur from August through the rest of the year. Phase 1 is targeted to begin in January of 2012 and includes high-level development, such as Ordinance changes. The steps that ERS will take to actually make an Ordinance change to the V3 system involve developing specifications in conjunction with the exact language of the Ordinance and then building the code that will eventually be placed into UAT, or User Acceptance Training. After UAT, the change is released into pre-production, tested by Vitech, and then released into final production.

In response to a question from the Chairman, Mr. Schroeder stated that lead times for implementing Ordinance amendments will be quicker and more efficient. In the past, a large enhancement was manually implemented while the actual system was being modified, which was a process that took six months. However, with the implementation now under ERS control, large changes should only take two or three months and small changes could be accomplished in a matter of weeks.

Mr. Schroeder then stated that the objective of the co-development process is to shift costs from Vitech to ERS at a projected approximate savings of 62%. More importantly, however, is control of the process and quicker and more efficient response to Ordinance changes in order for ERS to be compliant. The ultimate goal is for the system to be 100% compliant with all Ordinances. Currently, the system is approximately 90% compliant, but the last 10% is critical. Those must be manually administered.

Mr. Schroeder concluded by stating that the anticipated completion date of the co-development process is 2013. In 2009, all application changes were performed by Vitech. In 2010, ERS assumed 10% of the low-level changes, with Vitech retaining 90% of the work. ERS' responsibility increased to 40% in 2011 and by 2012, it is expected to further increase to 70%. By 2013, ERS will be handling 90% of the changes. Over this entire period, ERS is projecting that the cost of running the overall system will decrease from the current \$1.5 million to less than \$800,000.

In response to a question from Mr. Muller, Mr. Schroeder stated that the new system will be designed to comply with 100% of Ordinances. When the system initially became operational, errors were sometimes found that caused incorrect eligibility determinations for pension amounts. Currently, checks are in place to catch those errors, but they are corrected manually, which can sometimes be erratic and inconsistent. ERS wants the V3 system to correct the errors automatically so results are uniform and consistent.

Ms. Ninneman stated that an integral piece of the co-development process was the hiring of a County employee as the pension information system specialist. This person has an HR and systems background and should be an excellent fit. Once trained, this person will be responsible for making sure that the system is operating optimally with any implemented changes.

(c) Fiscal Officer/Cash Flow Report

Mr. Yerkes first discussed the ERS cash flow report, stating that there is an estimated \$2 million distribution for OBRA payments in August and September. Additionally, lump sum payment projections are \$2.5 million to cover increasing backDROP payments. These projections do not include any forecast for a surge of retirements at any particular time for things like changes in the pension system or sick pay payouts.

The Pension Board unanimously approved the liquidation of assets to fund cash flow of \$15 million for July 2011, \$20 million for August 2011, and \$15 million for September 2011. The amounts should be withdrawn from investments designated by Marquette. Motion by Dr. Peck, seconded by Ms. Bedford.

Mr. Yerkes next distributed the May 2011 Portfolio Activity report, noting that May cash flow came from the MCM Aggregate Bond Fund. Additionally, illiquid assets are only approximately \$400 million. When planning cash flow long term, some funds may be more difficult to turn into cash. For example, ERS has only quarterly access to long-short funds. Also, ERS can draw only a percentage of real estate and infrastructure funds per quarter. However, most assets, about \$1.4 billion, can be liquidated within a few days.

Mr. Yerkes then discussed the draft annual report that was previously e-mailed to the Board, and which contains three known changes. The letter from the Pension Board must be replaced. This letter is usually dated the same as the auditor's opinion letter, which also must be replaced. The date of the subsequent events printout, when received, must be changed.

Mr. Yerkes then stated that the annual report now includes long-short hedge funds and infrastructure. Additionally, ERS revised the description of the plan for consistency purposes.

In response to a question from the Chairman, Mr. Yerkes stated that last year's annual report was final on July 12 when the auditor's opinion letter was received and that this year the annual report should be final around the same time or earlier.

In response to a question from Mr. Schroeder, Mr. Yerkes stated that the Fund had a 12.1% return and that the auditor indicated that ERS would receive a clean opinion.

Mr. Yerkes requested that revisions and comments on the draft annual report be sent to him in the next few days.

6. Investments

(a) BNY Mellon

Mark Sullivan, Relationship Manager, introduced Michael Millette, Client Service Officer, and discussed BNY Mellon's client strategy. Mr. Sullivan handles the strategic operations, looking for ways to

reduce plan risk and increase assets. Mr. Millette handles the day-to-day plan transaction issues.

Mr. Sullivan then provided an update on BNY Mellon. BNY Mellon was voted the safest bank in the U.S. for the second year in a row by *Global Finance* magazine, and the 35th safest bank in the world. The rankings are based on liquidity and capital ratios. Additionally, the Bradley Foundation from Milwaukee became a BNY Mellon client in January 2011 and Mr. Sullivan is the client manager on that account.

Mr. Sullivan then discussed the recent press on custodian banks and how BNY Mellon operates with foreign currency exchanges. He noted that ERS and Marquette had passed along questions regarding FX procedure. BNY Mellon offers two methods of executing foreign currency exchanges, either directly negotiated with the FX desk, or a more hands-off approach where BNY Mellon is allowed to perform transactions within stated data ranges. For the most part, most managers hired by BNY Mellon clients will negotiate large trades and look for the best rates to execute trades. However, other managers elect to execute transactions based on standing instructions, which is where press coverage is focused. Managers allow BNY Mellon to perform exchanges based on standing instructions on smaller transactions, like dividend repatriation. BNY Mellon provides a new published rate for all unrestricted currencies every day and commits to executing an FX for those clients within that range for those currencies. The manager can opt out of any day's trading range if they believe it is not competitive. He stated that it would be cost-prohibitive for a manager to create its own FX trading desk capacity. This is why managers rely on custodians like BNY Mellon to perform the smaller transactions for them.

Mr. Sullivan continued that the number of FX transactions for ERS is very low. The ING Clarion Real Estate manager had approximately \$2 million in FX transactions over the past year. Of those transactions, 95% were performed away from BNY Mellon and 5% were performed with BNY Mellon, with 99% of the trades under \$100,000.

Mr. Sullivan stated that BNY Mellon's FX policies are available on its website. The policies state that when an international global manager is hired by a client, a new account is set up for the manager that includes whether that manager elected to negotiate or use standing instructions. When a manager performs a trade, the manager notifies BNY Mellon through the Workbench system. The manager will negotiate the trade. If BNY Mellon is chosen, the FX

exchange is executed in the BNY Mellon global markets group. The foreign exchange information will come through the Workbench platform and the trade will then be booked on the BNY Mellon system.

Mr. Sullivan then noted that BNY Mellon has effective foreign exchange professionals available to clients who want to discuss FX in more detail. Additionally, BNY Mellon can include FX transactions as part of its annual review for ERS. Mr. Sullivan stated that BNY Mellon is transparent about its FX operations and is willing to share any related and relevant data.

In response to a question from Mr. Wrubel, Mr. Sullivan stated that ERS trades are time-stamped.

In response to a question from Mr. Huff, Mr. Sullivan stated that he will meet with Mr. Caprio to provide more detail on whether BNY Mellon has complied with the specific ERS contract terms on FX.

Mr. Sullivan then discussed the most favored nation clause for ERS, which has an annual flat custodian fee of \$50,000. If BNY Mellon enters into a contract with a comparable client after the effective date of the ERS contract and then charges the comparable client a lower fee, the lower fee is then carried over to the ERS plan. A comparable client has custodial assets of between \$1 billion and \$1.5 billion and is not materially lower in complexity. To monitor this, a search is performed on BNY Mellon's entire client base and a list is created of all custodial assets between \$1 billion and \$1.5 billion. Any trust and custody fee below \$50,000 is highlighted and the account structure and service for that client are reviewed in more detail. If the client is not comparable, for example if one client had only one account and the other client had 25, the client is not compared.

In response to a question from the Chairman, Mr. Sullivan stated that certain servicing fees can be lower depending on ancillary considerations for that account and the type of relationship BNY Mellon has with the client. On an overall basis, some clients may provide more profit to BNY Mellon through other services. Mr. Sullivan assured the Board that ERS receives a very low and competitive fee from BNY Mellon.

In response to a question from Dr. Peck as to how securities lending fits into the ERS fee and whether revenue for securities lending is taken into account in a review of fees paid by other clients,

Mr. Sullivan stated that BNY Mellon looks only at trust and custody or other fee revenue.

Mr. Sullivan then provided an ERS securities lending review. In 2010, over \$70 million was out on loan. With the market improvement in 2010, equity valuations were up considerably and ERS benefited from that increase. Lendable treasuries was also up in 2010, but because Treasuries were not as popular, they did not make as much money. Regardless, the rise in equity contributed to the overall increase in earnings, from \$180,000 in 2009 to \$210, 000 in 2010.

In response to a question from the Chairman, Mr. Sullivan agreed that during the market turmoil, ERS looked at securities lending and the risk relative to the potential income it provided, and placed a cap on securities lending. Mr. Sullivan then stated that the rise from the \$70 million amount in 2010 to the \$115 million amount in 2011 was due to an incorrect adjustment to that cap by BNY Mellon. In November 2010, the cap was accidentally changed from \$68 million to \$680 million. When the error was discovered by BNY Mellon, the cap was changed the next day to the correct amount.

Mr. Sullivan continued that on the positive side, the market performed well and ERS made additional money. On the negative side, BNY Mellon's controls failed and ERS operated without a cap in effect for much of 2011. The \$68 million cap is now in place, effective June 13, 2011. Mr. Sullivan is working with the securities lending officer on controls to prevent this from happening again. Furthermore, Mr. Sullivan will work with Mr. Yerkes and Marquette to verify the numbers are correct each quarter.

In response to a question from the Chairman regarding illiquid assets with Sigma, Mr. Sullivan stated that since 2003, ERS has been invested in a collective commingled pool, called the ASL ERISA pool, with BNY Mellon. At the onset of the financial crisis, the ASL fund had no direct exposure to Lehman; however, there was an indirect investment through Sigma, a structured investment vehicle, or SIV. The Lehman impairment was supported by BNY Mellon for direct investments on other SIVs, but not on Sigma. Sigma's initial par value in ASL was \$260 million, or around 1% of the pool. The Fund's loss at the time of impairment because of Sigma was \$602,987, based on ownership in the pool. For the past two years, ERS has been applying monthly securities lending income toward the payable. As of June 10, 2011, the payable stands at \$397,033.

In response to a question from Dr. Peck, Mr. Sullivan stated that a securities lending report is available in the Workbench system that would indicate the amount of securities out on loan.

In response to Dr. Peck's statement that periodic checks need to be made to assure everything is correct, Mr. Wrubel stated that various reports are reviewed daily, monthly, and quarterly to do that.

In response to a question from the Chairman, Mr. Sullivan stated that the amount of ERS assets on loan is back within the cap, but that he is unsure how long the process to recall existing loans will take. Mr. Sullivan stated he will look into the matter.

Mr. Millette then discussed BNY Mellon's accomplishments and the annual service review of 2010. System and process enhancements were made to the BNY Mellon system and FBAR reports were added to the Workbench system. An alternative investment processing group was introduced to help clients abroad file for their foreign bank accounts. Controls for the client call back procedure were tightened and the call back waiver option was removed. Finally, BNY Mellon policy changes were made for revenue purposes.

Mr. Millette then discussed Client Service process enhancements, which he coordinates. Client Service provided audit support to Milwaukee County in March 2011. It also assisted Marquette with setting up accounts and wiring funds as needed. Additionally, Client Service set up and deleted users on the Workbench system as well as offered Workbench training as needed. In terms of global documentation, Client Service set up managers to trade in different markets.

Mr. Millette continued that key teams that support Milwaukee County are Relationship Management, Client Service, Client Accounting Reporting (or CARS), Performance Management and Risk Analysis, and Securities Lending. The CARS team is very active and works with Mr. Yerkes every week.

Mr. Sullivan then stated that the impact of the 2006 BNY and Mellon merger to ERS was negligible because ERS is still on the same platform. It was mostly Mellon executives who took over, so the Mellon client base, which included ERS, was the least impacted of the entire merged group. The merger is now fully functional and integrated.

In response to a question from the Chairman on the Workbench user review, Mr. Yerkes confirmed that ERS removes users on a regular basis as their positions change and that all user access right now is read-only.

Mr. Sullivan stated that BNY Mellon will provide a list of current users for Board review at BNY Mellon's next presentation.

The Chairman stated that it is beneficial for BNY Mellon to present annually to the Board, and the Board would make every effort to coordinate those visits with visits BNY Mellon had with its other Milwaukee clients.

(b) Marquette Associates Report

Ray Caprio and Brian Wrubel of Marquette Associates, Inc. distributed the monthly report.

Mr. Caprio first provided an overview of some ERS asset classes for the benefit of the newer Board members. The first asset class is fixed income. J.P. Morgan and BNY Mellon currently manage fixed income assets. J.P. Morgan is an active manager that picks bonds to outperform the market. BNY Mellon is an index manager. There is a total of \$560 million in fixed income assets, about 40% of the Fund, with a target of 32% of the Fund. Marquette will continue to naturally rebalance the portfolio through monthly benefit payments.

The second asset class is publically-traded U.S. equity, which is comprised mainly of active managers in multiple and varying asset classes ranging from large-cap core to small-cap value. The idea is to fully diversify the equities without over-diversifying in an effort to beat the broad markets. There is a little over \$440 million in U.S. equity assets representing approximately 23.4% of the Fund.

Mr. Caprio continued that the asset classes are broken down into different styles. The real estate asset class, which is one of ERS' newer asset classes, is broken into publically-traded REITS managed by ING. Real estate is a little over \$112 million, about 6% of the Fund, with a target of 7%. The remaining asset classes of the Fund are those that Marquette added since Marquette was hired. Marquette has been actively filling those asset classes since 2009 through searches and through commitments to particular managers and asset classes. Total Fund assets at the end of May 2011 were a little below \$1.8 billion. A sizable amount was taken out in benefit payments, and that will continue.

Mr. Caprio next discussed Fund performance. Marquette reports gross of fees monthly, and gross and net are reported quarterly. The total Fund was down 60 basis points for the month of May. Year-to-date, however, the Fund is up 5.1%. Most managers are actively beating their benchmarks. Active management and diversification in the asset classes have paid off. The year-to-date return for fixed income is 3%, which is in line with the benchmark. Over the long term, fixed income has continually outperformed its benchmark. Marquette anticipates that U.S. equity, international, hedged equity, real estate, and infrastructure will continue to do the same thing.

Mr. Wrubel noted that the fact that the managers are exceeding their benchmarks is an important part of achieving ERS' strategy. All of the combined portfolios are actually performing fairly well relative to where they should be.

Mr. Caprio then discussed the performance of the Fund managers. In any given month, there are winners and losers. In May, it was fixed income relative to U.S. equities. Within U.S. equities, it was large-cap over small-cap. As investors become more conservative, there is a flight to quality. Year-to-date, Boston Partners, a large-cap value manager, is performing well relative to its benchmark. Mid-cap growth is underperforming slightly, but long-term has performed well, especially Artisan. The performance of Reinhart Partners will continue to be monitored, as its style seems to be out of favor right now. In small-cap, it is difficult for Marquette to truly assess performance on a monthly basis for AQR and Fiduciary Management because Marquette believes ERS should look more long term. Both have good strategies, are fundamental in terms of stock picking, and have proven track records, which is why they are in the Fund. In international, Barings and GMO large-cap are on alert. In the near term, it looks like GMO's style is going to be favored and they have fared well recently. However, there is still a 3- to 5-year gap where they are not performing as well relative to the benchmark, so Marquette recommends it stay on alert. Barings is still on alert as a byproduct of an organizational change, and Marquette will continue to monitor that. In alternative investments, it is a good month to look at what the hedged equity managers are doing. They are down, but only slightly, and are protecting capital in the short term. Additionally, the one-year numbers are available for ABS and K2 who performed at 11.8% and 8.8% respectively relative to the traditional markets and large-cap. Small-cap performed at about half that, but there is a lot less volatility. Mr. Wrubel added that hedged equity is down 1% for the month so far versus 5% for the market.

In response to a statement from the Chairman, Mr. Caprio agreed that Barings should attend an Investment Committee meeting in order to discuss what is happening with it and its strategy.

Mr. Wrubel stated that reviewing the ten-year annualized investments and how well the overall bond market performed is instructive. The BarCap Aggregated value index is up almost 6%, so while it did not meet the actuarial rate of return, it did provide fairly stable returns over that period. The S&P 500 is only up 2.6% and large-cap stocks are up 2½%. However, with mid-cap stocks, and mid-cap growth in particular, Artisan is up 8% for that ten-year period. There was some volatility, but the return is close to the actuarial rate of return and well ahead of the S&P 500. For small-cap, the Russell 2000 Value was up 8.2% and also ahead of the actuarial rate of return. Value orientation is an area of focus for the Fund. International stocks, like GMO large-cap, are up 8%, so they have outperformed their benchmark but are in line with their actuarial return rate. International small-cap and emerging markets are up 12½% and 16½%, respectively, well ahead of 8%, and well ahead of the 2½% of the S&P 500.

Mr. Muller requested a copy of Marquette's due diligence process.

Mr. Wrubel then provided an overview of commercial real estate, to which the ERS Fund currently has allocations. He stated that commercial real estate is an interesting asset class with a number of benefits. It is in the news often, it is a good diversifier and, from a timing perspective, it is a good time to enter the market. The broad real estate market from U.S. International is a very large market with significant opportunities. The ten-year Treasury today yields approximately 3.1%. One of the reasons Marquette looks at real estate, especially on the core side, is for attractive and healthy income and risk-adjusted return performance. Additionally, there is a large, investable universe across the country with different sectors of the market, so very low or very good diversification from the stock and bond market exists there. Commercial real estate is also an inflation hedge in terms of increasing rents.

Mr. Wrubel then stated that in terms of historical performance, the NFI-ODCE is the real estate open-end universe that Marquette looks at. It has been averaging about 8% over a 1978 to 2010 time period, and 95% of that return comes from income and not from appreciation. It is composed primarily of core-type real estate. REIT, like the S&P 500 and international stocks, is somewhat risky for the type of return. Marquette believes the risk stream is very

attractive for commercial real estate and very similar to the bond market.

Mr. Wrubel then noted traditional real estate includes office, industrial, retail, and multifamily properties. Non-traditional real estate includes hotels, self storage, and medical office type buildings. All types of real estate are very attractive and accessible across the country. Real estate is also very local in that what works in Milwaukee might not necessarily work somewhere else. It is important to understand the market a fund is in and what is happening with it.

Mr. Wrubel then discussed the life cycle characteristics of different real estate investments. Currently, Marquette focuses primarily on operating or stabilized real estate, which is a very conservative and more income-producing approach to real estate as opposed to development. First, there is the forward purchase commitment, which is a commitment to purchase something at a pre-specified price when all conditions agreed to are met. In the pre-development cycle, there is basically raw land, or land undergoing development. In development, the property is under construction. Initial leasing involves a building that is partially under construction but that is leased up. The operating or stabilized cycle is a building that is finished and operating and at least 80% tenanted. Finally, there is repositioning or redevelopment which is a property that is undergoing repositioning.

Mr. Wrubel stated that there are three real estate investment styles; core, value-added, and opportunistic. Core real estate, in which Marquette primarily operates, includes basic operating properties, whether multifamily, industrial, office, or retail, and is typically at least 80% leased, very high-quality, and in the major business districts like Chicago or L.A.. There is also a value-added style, which typically has higher leverage. Because of the leasing, development, and repositioning risks, more risk is added to the portfolio. Accordingly, though, potential return is added, as well. In core real estate, typically about 90% of the return is from income and value-added. In opportunistic, 90% to almost 100% of the return is from appreciation. It is highly leveraged with much higher risk. The potential for reward is also significantly higher, as much as double the return of a core-type property.

Mr. Wrubel then stated that core real estate usually involves buying a property and holding on to it for an extended period of time. With value-added or opportunistic, however, there is more of a total return and it is not held as long, especially on the opportunistic side where

there is development and stabilization. Additionally, investment vehicles are important in that, in a core space, they are generally open-end, or liquid. Money can be received back on a quarterly basis. On value-added or opportunistic, the focus is usually on closed-end vehicles, meaning that money is locked up for usually a period of 7 to 12 years. This is a longer term investment that is more illiquid and has significantly higher fees.

Mr. Wrubel then discussed the risks in commercial real estate. As with any investment, whether stocks, bonds, or real estate, there are risks associated with the sector. Some of those risks include liquidity. When times are good, a manager can sell a building, reposition a building, obtain debt for a building, and find buyers and sellers for a building. When times are tough, as in 2008, liquidity constraints come in to play. The open-end funds were not so open-end and they were cues to get out of real estate. Now there are cues to get back in to real estate, so leverage can help or hinder. Additionally, it is important to understand what the managers are buying and their financials. Diversification is also key to minimizing risk. Finally, for valuation purposes, it is important to make sure best practices are in place for the appraisal process and to remember it is just that, an appraisal. Until actually at the market to either buy or sell a property, there is no way to know the precise value of a property. Markets are volatile and depend on demand and supply.

In response to a question from Ms. Bedford, Mr. Wrubel stated that there is tremendous opportunity in real estate because of the real estate crisis. There is a high demand for core properties and there are write-ups in appraisals and values after significant write-downs. Prices are still below purchase prices and core values still exist.

Mr. Wrubel then discussed Marquette's proprietary asset allocation model, which looks at interest rates and various simulated economic factors. Thousand of different studies are run, and they project out based on current interest rates and where earnings are to produce allocations, returns, or risk. Marquette focused on two key areas, real estate and private equity. A main concern is the 32% allocation to fixed income with an 8% actuarial rate of return. It will be very difficult to generate those types of returns in the bond market and so it could be a drag on the portfolio. Marquette wants to look for ways to bring down the bond allocation. Portfolio A drops the fixed income component from 32% to 29% and adds opportunistic real estate. This should take the potential return stream from 8.6% to 9.14%. It reduces the probability of not achieving the actuarial rate

of return over a ten-year period from 44% to 38%, which is fairly significant, and reduces the downside risk from 3.4% to 2.9%. It also increases illiquid assets from 10% to 13%. Portfolio B drops the fixed income to 27% and adds private equity. Reducing fixed income and adding to opportunistic real estate and private equity takes the average annualized ten-year return from the current 8.6% to 9.14% in Portfolio A and to 9.4% in Portfolio B.

In response to questions from the Chairman and Mr. Muller, Mr. Wrubel stated that Marquette classifies infrastructure and private equity as illiquid. Real estate and hedge funds are not included because there is no quarterly draw. It is really a matter of closed-end versus open-end funds. Infrastructure is considered illiquid even though it is not closed-end.

In response to a question from Mr. Muller, Mr. Wrubel stated that calculating probability focuses more on downside risk optimized to the 8% return. Marquette looks for somewhat stable returns from an asset class in fixed income, which is estimated to provide a 5% rate of return.

In response to a question from Mr. Muller, Mr. Wrubel stated that capture ratios cannot be calculated from this model because Marquette is not looking at prior up market and down market data. The model is more forward-looking.

Mr. Wrubel stated that Portfolio A looks at cash flow and funding ratio, which is based on the actuarial report, or projected future cash flows. Projected market value in the 50th percentile is the expected return, with the 5th percentile as the worst case scenario and the 95th percentile as the best case scenario. Over a ten-year period, Marquette expects growth from \$1.9 billion to approximately \$2.7 billion. Worst case scenario, there should still be \$1.3 billion in assets.

Mr. Wrubel continued that from a funded standpoint, in terms of how the liability is projected to grow based on the actuarial assumption, the ratio increases from 89% to 111% funded in the 50th percentile. For the worst case scenario, or that 5th percentile, it is 53% funded, and the best case, the 95th percentile, it is 230% funded. So it is really a best case, worst case scenario and not necessarily up market, down market.

In response to a question from Dr. Peck about investing in opportunistic real estate, Mr. Wrubel stated that investing is a lot about timing and entry points. Marquette feels it is not a particularly

good time to be invested in fixed income. The opportunities in the opportunistic real estate sector are starting to look more attractive, and Marquette most likely would not have looked at that sector two years ago.

In response to a question from Mr. Grady, Mr. Wrubel stated that the reasoning behind electing 3% more in opportunistic real estate as opposed to just 3% more in core is based strictly on returns. Currently, the portfolio is 100% core and Marquette expects an 8% to 8½% return. However, returns can be enhanced over time from an 80/20 or 70/30 split in the core opportunistic sector.

In response to a statement made by Dr. Peck, Mr. Wrubel agreed it would be beneficial for Marquette to discuss more in-depth at an Investment Committee meeting the reasoning behind why now is the time for an investment in opportunistic real estate.

Mr. Wrubel then stated that Marquette is not looking for major allocation changes. If interest rates do not increase, ERS will earn approximately 3.5% to 4% in the bond portfolio, which will be a drag relative to actuarial rate of return. Investing in opportunistic real estate is a way to diversify in order to achieve an 8% return without too much risk.

In response to a question from the Chairman on how increasing the allocation to hedge funds using different strategies would affect the portfolio, Mr. Wrubel stated that multi-strategy fund-of-funds are less liquid than hedged equity. They typically have a lot more leverage built into them with longer lock-up periods. Marquette can explore this area in a little more detail.

In response to a question from Mr. Grady, Mr. Wrubel stated that Portfolio A is the preferred strategy for Marquette.

In response to a question from Mr. Sikorski, Mr. Wrubel stated that moving away from peers in portfolio design is an attempt to consistently reach the 8% rate of return without undue risk. A typical public fund is roughly 65% stocks and 35% bonds. Predominantly, the larger public funds have hedge funds in a 5% to 10% range. Infrastructure has been an area they have not accessed quite as heavily. From a purist standpoint, the ERS portfolio does look different than the typical public fund, but that is not necessarily a bad thing. Marquette expects the portfolio to keep pace with the broad market, but with 15% to 20% less risk.

The Chairman then stated that the Board will need to learn to balance comfort with liquidity versus a higher return. Mr. Wrubel stated that Marquette could create a liquidity spreadsheet for the Board to show each investment and its purpose and timing and, at Mr. Grady's suggestion, it could also include cash flow needs.

The Chairman then stated that it might be beneficial to see what the ERS portfolio would look like in a 20% market downturn with tradable holdings to see whether that would create large constraints on how much liquidity ERS has and whether ERS would be able to meet its commitments. It could significantly change ERS' asset allocation.

Mr. Wrubel stated that assuming a somewhat gradual 20% downturn, hedged equity would most likely perform fairly well during that period. In the bond market, a flight to quality would likely occur. The real estate portfolio would not react quite as strongly or as quickly as the public markets. In private equity, a 20% downturn would translate to 7% to 8% overall. It would also be an opportunity to rebalance. Marquette will put more data around this scenario to produce a better projection.

The Chairman suggested that this is a topic to be placed on the Investment Committee agenda.

In response to a question from the Chairman, Mr. Caprio indicated there was no need for any rebalancing at this time.

Mr. Caprio then stated that the full quarterly report will be presented at the next Board meeting, as usual.

7. Investment Committee Report

The Chairman reported on the June 6, 2011 Investment Committee meeting and noted the ERS Fund is largely outperforming its benchmarks. Marquette discussed the fine-tuning of ERS asset allocations by adding more opportunistic real estate and raising the private equity percentage.

8. Audit Committee Report

Mr. Grady reported on the June 2, 2011 Audit Committee meeting. Baker Tilly presented a clean audit review with no material errors in the Plan and with minor recommendations. Mr. Schroeder drafted a response to these recommendations, which will be presented to the Board at a future meeting, and has already sent the draft to the Board for review. Mr. Schroeder noted that auditor recommendations are non-binding recommendations and are reduced from 6 to 8 last year to only 2 this year. Mr. Schroeder then stated

the audit revealed that testing deficiencies were in the normal range and financial statements were within standard deviation. Additionally, this year, ERS trained the auditors to use the V3 system so they could navigate the system themselves, which proved to be helpful.

The Audit Committee then discussed employee contributions, which are already starting for some members and will soon start for approximately 95% of the members. Various forms need to be revised because of the ability to designate a beneficiary for contributions where a refund is possible in the event of death. In the past, few people made contributions so these forms were relatively insignificant. Mr. Huff will bring final drafts of these revised forms to the next Audit Committee meeting.

Mr. Grady stated that the committee discussed the possibility of creating a retirement handbook. Over the past several years, the Retirement System has published very simple brochures on various topics. Dave Arena, when he was the ERS Benefits Manager, wanted to create a much more detailed handbook to describe benefits to employees. For a few years now, the Retirement System has been working on a handbook. The Audit Committee discussed legal concerns because a handbook begins to look like a summary plan description under the law and there is case law in the ERISA context where courts have held pension plans to the terms of their summary plan description even if it was different from the actual plan document. Because of the complexity of the ERS plan, the question is whether to move forward with a substantial draft. There are many factors to consider, such as the different benefits for each of the 8 unions; non-represented employees and elected officials; and the different benefits for members within the same union based on date of hire. Additionally, there are many variations in programming. For example, there are currently 8 employees who, because of a state law change two years ago, were made state employees as part of the income maintenance reorganization on behalf of the state for child care benefits. These employees, who had been County employees, were by state law given the option to stay in the County Retirement System even though they are now state employees. As a result, they have to be flagged and tracked individually. A decision must be made as to how to handle these situations. With the handbook, ERS needs to be informative and attempt to reduce the number of calls and questions to ERS staff. On the other hand, care must be taken to ensure ERS is not caught in a legal situation where its summary plan description or handbook contains errors or inadequacies. The committee discussed whether a different handbook should be issued for each union, but that still does not cover situations where employees transfer from one union to another, or from non-represented employee status to represented employee status. The end result was that this situation needs to be further discussed by the Retirement Office.

In response to a question from the Chairman, Mr. Huff stated that other plans have complexities and most have very complete summary plan descriptions. The problem is that the courts require a fairly detailed level of disclosure, which makes handling one-offs and maintaining full disclosure very difficult.

Mr. Schroeder then stated that the City of Milwaukee issued a handbook ten years ago which has been updated every two or three years. His interpretation of this Audit Committee topic was that in order to salvage the two years' worth of work on the handbook, another attempt would be made to incorporate suggestions from counsel and to address additional differences between the unions. Employees are entitled to plan information and it is ERS' responsibility to get that information to them. Therefore, the Retirement Office will revise the handbook.

Mr. Grady stated that a system tool is available that was developed by Buck Consultants—a spreadsheet with every union type and the factors that are part of the calculations and benefit levels, such as dates of hire. It would be possible to pull that information out union by union and create separate handbooks. However, some background knowledge is required to even understand how to look at that data. Overall, however, ERS needs to find the best way to balance the level of detail with the legal risks.

The Audit Committee next discussed the County change to the normal retirement age from 60 to 64 for some employees and whether any Ordinances need to be amended as a result. The early reduced retirement option allows that an employee entitled to a retirement age of 60 can retire at age 55, or any year between 55 and 60, with a reduction in benefits of 5% per year. Previously, if that employee retired at age 59, there would be a 5% reduction of benefits. If that employee retired at age 55, there would be a 25% reduction of benefits. No changes were made to Ordinance sections that covered early reduced pensions when an employee has a retirement age of 64. The committee interprets this to mean that an employee can still retire at age 55, but with a 45% reduction in benefits because of the nine year difference. Since this cannot occur until 15 years of service and since people have only just started getting hired under the age 64 requirement, the issue is not an immediate concern. ERS intends to add this as a suggested fix in conjunction with a future ERS County Ordinance change to be considered by the County Board. Specifically, any employee with age 64 as a retirement age could start the early reduced retirement at age 59.

The Audit Committee then discussed the overall OBRA update. The IRS has given the Retirement System permission to start paying out members who have reached age 70½. There are currently approximately 36 of these members.

Mr. Schroeder then stated that it was brought up at the Audit Committee meeting that ERS hired two temporary staff—one hotline operator and one data entry person. ERS staff is meeting weekly to coordinate how payments will be made and what needs to be done to make that happen. Activity logs and reports were created so that ERS can come back to the Board to report on progress for paying out OBRA.

Mr. Grady then noted that ERS is in the process of issuing an RFI to financial organizations to hold funds for members who cannot be found. ERS hopes to have IRS permission to pay the monies for unfound individuals to institutions that will hold it for those members.

The Audit Committee concluded with a discussion on waivers. Former County Executive Walker requested that certain department heads and appointed officials sign various forms of waivers of benefit. The Board's role was to make sure that the waivers came in on the appropriate form. The Board did not request the forms, it simply accepted them. Mr. Grady stated that the request the former County Executive made for waivers ended when his administration ended.

In response to question from the Chairman, Mr. Grady stated that existing waivers are valid.

In response to a question from Mr. Muller, Mr. Grady stated that the former County Executive implemented these waivers as a condition of hire for a limited number of people, such as at-will employees, cabinet members, and some department heads. The waivers applied to the increases passed in 2000.

9. Proposed Ordinance Amendments

Mr. Grady provided the background on the proposed Ordinance amendments. In anticipation of the collective bargaining law becoming law, the County Retirement System will have to take state-mandated contributions from certain members beginning at various points in time. The Ordinance amendments codify that the County Retirement System will do so, consistent with the state law requirement, and do so on a pre-tax basis. Without the Ordinance amendments, state-mandated employee contributions will be made on an after-tax basis. Mr. Schroeder indicated previously that because the system is already set up for contributions from non-represented employees and elected officials under County requirements, there is no additional administrative implementation cost for these amendments.

In response to a question from the Chairman, Mr. Grady confirmed that none of the unions have employee contributions. Currently, only non-

represented employees and elected officials have employee contributions, and those contributions are on a pre-tax basis due to a previous amendment. The amendments discussed today extend the pre-tax basis to state contributions, which are calculated differently. County contributions are a flat percentage. The state-mandated contribution will vary every year, based on an actuarial calculation, because state law dictates that employees pay one-half of the actuarially required contributions. County Ordinances must be amended to reflect the different formula under state law. This change will be implemented immediately for non-represented employees, elected officials, and, unless there is a change in the next two weeks, AFSCME members. It will also be implemented, unless there is a change in the next two weeks, as of January 1, 2012 for all other unions. State law originally indicated public safety workers like deputy sheriffs and firefighters were exempted, but this is something that is still being researched.

In response to a question from the Chairman, Mr. Grady stated that the County Board has not yet acted. The amendments will go to the County Board Finance Committee for approval, and then to the Personnel Committee and Pension Study Commission, and then to the full County Board.

In response to a question from Mr. Muller, Mr. Grady stated that there is a requirement in a County Ordinance that states every change in the Pension System will be referred to the Pension Board for comment. The Pension Board is then given 30 days to comment if it chooses to do so.

The Pension Board unanimously approved the adoption of the following resolution:

The Pension Board offers no formal comment regarding the proposed Ordinance amendments to sections 201.24(3.3), (3.5), and (3.11) of the Milwaukee County Code of General Ordinances documenting and picking up state-mandated employee contributions, and waives the balance of its 30 day comment period provided for under section 201.24(8.17) of the Milwaukee County Code of General Ordinances. The Employees' Retirement System ("ERS") Manager estimates that implementation of the proposed Ordinance amendments would not result in additional cost to the System. The Pension Board believes that it is in the best interests of ERS for the County Board to adopt Ordinance amendments which clarify the intended operation of the Ordinances in accordance with legal requirements.

Motion by Ms. Bedford, seconded by Dr. Peck.

10. Administrative Matters

The Pension Board discussed additions and deletions to the Pension Board, Audit Committee, and Investment Committee agendas. The Chairman asked that anyone with future topic suggestions should voice them. Those topics will be discussed at the next agenda planning meeting.

The Board discussed the educational value of the Hedge Fund Investor Symposium in New York on June 21 and June 22, 2012 but did not take action.

Ms. Bedford moved that the Pension Board adjourn into closed session under the provisions of Wisconsin Statutes section 19.85(1)(g), with regard to items 12 and 13 for the purpose of the Board receiving oral or written advice from legal counsel concerning strategy to be adopted with respect to pending or possible litigation. At the conclusion of the closed session, the Board may reconvene in open session to take whatever actions it may deem necessary concerning these matters.

The Pension Board voted by roll call vote 5-0 to enter into closed session to discuss agenda items 12 and 13. Motion by Ms. Bedford, seconded by Dr. Peck.

11. Disability Matters

(a) Applications

(i) Bryant White, ADR

After returning to open session, the Pension Board discussed Bryant White's accidental disability pension. The Medical Board recommended that the Pension Board grant Mr. White's accidental disability pension application if an appropriate vacant position within ERS could not be found. The Board noted that no position could be found.

In open session, the Pension Board unanimously approved accepting the Medical Board's recommendation to grant an accidental disability pension application. Motion by Mr. Sikorski, seconded by Ms. Bedford.

12. Pending Litigation

(a) Mark Ryan, et al. v. Pension Board

The Pension Board took no action on this item.

(b) Travelers Casualty v. ERS & Mercer

The Pension Board took no action on this item.

(c) ERS v. Lynne Marks

The Pension Board took no action on this item.

(d) Christine Mielcarek v. ERS

The Pension Board took no action on this item.

(e) Lucky Crowley v. ERS

The Pension Board took no action on this item.

13. Report on Compliance Review

The Pension Board took no action on this item.

14. Adjournment

The meeting adjourned at 11:20 a.m.

Submitted by Steven D. Huff,
Secretary of the Pension Board